Recent Changes in the Bank and Corporation Franchise Tax Act

Roger J. Traynor
Frank M. Keesling

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Recent Changes in the Bank and Corporation Franchise Tax Act

III.

The article which this third instalment concludes set out to analyze the 1933 amendments to the Bank and Corporation Franchise Tax Act, the reasons leading to their adoption, and certain problems still inherent in the operation of the Act which may become the source of future changes. The amendments are considered approximately in the order of the sections which they affect. The article opened with a detailed survey of the corporations taxable under the Act, together with a discussion of the new definition of “doing business,” the virtual elimination of property tax offsets, and the new method of computing the tax rate applicable to banks. The second instalment examined the validity of the bank tax rate with reference to section 5219 of the United States Revised Statutes, as well as to the Constitution of California, and discussed the definition and classification of financial corporations for rate purposes. This final instalment takes up the remaining changes in the Act.¹

Adjustments for Fiscal Year Corporations Necessitated by Changes in the Law

As some corporations report on a calendar year basis and others on a fiscal year basis, some adjustment is necessary if changes in the law are to apply equally to all corporations. Otherwise such changes would apply to fiscal year corporations either at an earlier or later date than to calendar year corporations. Section 4 of the amended Act accordingly sets forth a procedure whereby both fiscal year and calendar year corporations will be treated with substantial equality.² Here, substantially as under section 105 of the Federal Revenue Act of 1932, when the law applicable to calendar year corporations, for one calendar year, differs from the law applicable to calendar year corporations for the second calendar year, the taxes for fiscal year corporations, whose fiscal years are partly within both such calendar years, shall be computed partly under the old law and partly under the new law in the proportion which the number of months in each of the two calendar years bears to the entire fiscal year which falls partly in both of such calendar years.

The question has arisen whether the above provisions are applicable to the computation of taxes for fiscal years which began in 1932

¹ For the first and second instalments, see (1933) 21 Calif. L. Rev. 543 and (1934) 22 ibid. 499.
² Cal. Stats. 1933, c. 303, p. 870.
and ended in 1933. Each of the bills creating the 1933 amendments, including the one providing for the above changes, provided:8 "This act . . . shall be applied in the computation of taxes accruing subsequent to Dec. 31, 1932." Since section 4 of the Act provides that the taxes imposed by the Act shall accrue on the first day after the taxable year, and since "taxable year" is defined by section 11 as the year serving as the basis for the computation of the net income used as the measure of the tax, the amendments, even though not passed until after the beginning of 1933, seem clearly to apply to the computation of taxes for calendar year corporations for the year 1933. The law for calendar year corporations for the calendar year 1933 thus differs from the corresponding law for the preceding calendar year for calendar year corporations. Section 4, by its own plain terms, therefore, in providing for an adjustment for fiscal year corporations, seems clearly applicable to the computation of taxes of such corporations for fiscal years falling within both of such calendar years.

The taxes imposed under section 4 accrue on the first day after the close of the taxable year; the taxes for fiscal years beginning in 1932 and ending in 1933 accrued prior to December 31, 1932. Does this leave the way open for an argument that the 1933 amendments adding the adjustment provisions to section 4 are not applicable to the computation of such taxes?

Had the bills creating the 1933 amendments failed to provide that they should cover the computation of taxes accruing on or after December 31, 1932, it would have been arguable that such amendments, not becoming effective until May, 1933, applied only to the computation of taxes for fiscal or calendar years commencing after the effective date of the amendments. The bills do so provide, however, and the legislature thus made certain that the amendments would apply to the computation of taxes for the calendar year 1933 and for fiscal years beginning in 1933 before the amendments became effective. In view of the additional provisions for adjustment in the taxes for fiscal year corporations, falling within the calendar years 1932 and 1933, the legislature evidently intended that the adjustment provisions added to section 4 should apply to the computation of taxes for such fiscal year corporations. Had it not so intended, why would it have specifically provided for such adjustments? Furthermore, the provision of the bills creating the 1933 amendments making them applicable to the computation of taxes accruing subsequent to December 31, 1932, does not expressly preclude the application of the amendments to taxes accruing at an earlier date. Nor is there any reason to suppose that this provision was

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8 Cal. Stats. 1933, cc. 209, 210, 303.
in any way designed to postpone the application of the amendments. The provision seems intended to insure the opposite result, namely, that the amendments apply to the computation of taxes for the calendar year 1933 and fiscal years commencing in 1933 prior to the time the amendments became effective. In the absence of a contrary provision, the amendments would seem applicable to the computation of taxes for calendar and fiscal years current as of the time the amendments became effective,\(^4\) \textit{i.e.}, fiscal years which began in 1932 and ended on or after May 31, 1933.

**The Basic Date for Determining Depreciation, Depletion and Gain or Loss**

The Act of 1929 provided that depreciation, depletion and gain or loss in the case of property acquired prior to January 1, 1928, should be computed upon the basis of its fair market value as of that date.\(^5\) The 1931 amendments retained this basis for all purposes except deductions for depletion in oil and gas wells.\(^6\) These provisions were objectionable on several grounds. Depreciation and depletion could be computed upon the basis of the abnormally high property values of 1928, which often exceeded the cost as well as the value of the property at the time of computation.\(^7\) Furthermore, it was impossible to tax gains realized from the sale of property, even though they accrued after the effective date of the Act, if the selling price happened to be less than


\(^5\) Cal. Stats. 1929, c. 13, §§ 8, 19, pp. 21, 27.

\(^6\) Section 8(g) as amended in 1931 provided: “In the case of oil and gas wells the allowance for depletion shall be \(27\frac{1}{2}\) per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed in the manner provided in sections 113 and 114 of said Revenue Act of 1928.” Cal. Stats. 1931, p. 61. This amendment denied the right to compute depletion on the basis of 1928 values as an alternative to the percentage method and by so doing allowed no deduction for increases in value between the date of acquisition or March 1, 1913, and January 1, 1928. A case involving the validity of this change is now pending in the California Supreme Court. Fullerton Oil Co. v. Johnson, L. A. No. 14017. For a discussion of the retroactive aspects of the change, see Traynor, \textit{op. cit. supra} note 4, at 737.

\(^7\) It is possible that losses might also have been computed upon the basis of January 1, 1928 values even though the sale price of the property exceeded the cost of the property. If, however, the California courts followed the rule of United States v. Flannery (1925) 268 U. S. 98, losses could have been deducted only to the extent the cost exceeded the sale price of the property, regardless of the January 1, 1928 valuation of the property. See Traynor, \textit{op. cit. supra} note 4, at 727.
the January 1, 1928 value of the property. While there might be some argument against taxing gains which accrued before the effective date of the Act, even though realized thereafter, it is difficult to see why the state should not tax gains which both accrue and are realized after the Act became effective. Finally, the use of January 1, 1928, as a basic date offered an opportunity for evading taxation by means of excessive valuations which were difficult to disprove.

The 1933 amendments abandon this basic date entirely. Instead they provide for the computation of depreciation, depletion and gain or loss substantially in accordance with the provisions of sections 113 and 114 of the Federal Revenue Act of 1932, which use cost as the basis for property acquired after March 1, 1913, and cost or the March 1, 1913 value, whichever is greater, as the basis for property acquired prior to that time. They thus prevent deductions based on abnormally high values; they prevent also the evasion of taxation of actual gains realized from the sale of property. While the basic date now established in the Act makes it necessary to ascertain the value of property as of March 1, 1913, when acquired before that date, this is simpler than ascertaining the January 1, 1928 value, since in most instances the March 1, 1913 values have already been determined for federal income tax purposes.

DEDUCTION OF FEDERAL INCOME TAX AND FRANCHISE TAXES OF OTHER STATES

Under the Act prior to the 1933 amendments, federal income taxes and, probably, franchise taxes of other states measured by net income were deductible from gross income in arriving at net income. They are no longer deductible under the Act as it now reads.

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8 Suppose A corporation purchased property in 1920 for $100,000, and that its value on January 1, 1928, was $200,000 and that its value on January 1, 1932, was $100,000. Suppose, further, that B corporation purchased identical property on January 1, 1932, for $100,000. If the property in each case rises in value to and is sold for $200,000 in 1935, both corporations will realize a gain of $100,000 accruing after the Act became effective. B will be taxable upon the full amount of its gain, but under the old provisions establishing the value of property on January 1, 1928, as the basis for determining gain on property acquired prior thereto A would not be taxable on its gain since the selling price does not exceed the January 1, 1928 value. It is difficult to see why the fact that A purchased its property prior to January 1, 1928, should justify the difference in treatment which would have been accorded these two corporations.


10 The validity of the above changes will be discussed in a later issue of the Review.

11 § 8 (c) as amended by Cal. Stats. 1931, c. 64, p. 60.

12 § 8 (c) as amended by Cal. Stats. 1933, c. 209, p. 687.
DIVIDENDS AND SUBSCRIPTION RIGHTS

Section 6 was amended to provide expressly that stock dividends and subscription rights should not be included in gross income, but that gain or loss might be derived or sustained by the shareholders from the sale of such stock or the sale of such rights. This amendment, designed merely to clarify the original section, probably effects no change in the law.

Section 8 (h) formerly allowed a deduction from gross income of dividends received "from income arising out of business done in this state." This wording permitted the deduction not only of dividends from corporations taxable under the Act but also those from public utilities, insurance companies, and Federal Reserve and Federal Land Banks. It left in doubt, however, the deductibility of dividends from foreign corporations not doing business here, when such dividends were derived from income representing dividends declared by corporations out of income from California business. It also left in doubt the deductibility of dividends received from domestic holding companies. As amended, section 8 (h) allows the deduction of dividends "from a bank or corporation doing business in this state" declared from income arising out of business done in this state," but this deduction "shall not

15 Railroad and street railway companies, car companies, express companies, gas and electric companies, and highway transportation companies operating as common carriers between fixed termini and over regular routes are taxed on the basis of their gross receipts from operation in lieu of all other taxes and licenses. This method of taxation will continue in effect until January 1, 1935, at which time the above companies will become subject to the Bank and Corporation Franchise Tax Act to the same extent as other business corporations. See Cal. Const. (1933) art. XIII, §§ 14½, 15½.

Insurance companies are taxed on the basis of their gross premiums in lieu of all other taxes and licenses except taxes upon their real property. Cal. Const. (1910) art. XIII, § 14. No provision has been made for abandoning this method of taxing such companies.

It is arguable that under this wording such dividends were deductible on the basis of their original source, California business, regardless of how far removed. On the other hand, one could contend that the deduction applied only to dividends paid out of income used in the measure of a tax on the declaring corporation, and that when the income earned in California passed into the hands of a foreign corporation not taxable under the Act it lost its character as California income. The State Board of Equalization sustained the latter contention in The Matter of The Appeal of Corporation of America (decided October 12, 1932) involving the deductibility of dividends received from Transamerica Corporation, a foreign corporation not doing business in this state. The Board was reversed by the superior court of Sacramento County. Corporation of America v. Johnson (Jan. 31, 1934) Case No. 48743, Dept. 2, Decree No. 28541. The case is now before the district court of appeal.

17 See the first installment of this article for a discussion of this problem, (1933) 21 Cal. L. Rev. 543, 547-550.
apply to dividends received from corporations not taxable under Article XIII of the Constitution... This wording still permits the deduction of dividends from corporations taxable under the Act and from public utilities and insurance companies. It prevents, however, the deduction of dividends from corporations such as Federal Reserve and Federal Land Banks not taxable under the state constitution, in keeping with the purpose of the amended Act to allow only deductions necessary to avoid double taxation. It likewise prevents the deduction of dividends from foreign corporations not doing business here even though their original source may be income from California business. Finally, it prevents the deduction of dividends from domestic holding companies, regardless of their original source, inasmuch as holding companies are now declared not to be business corporations doing business in this state.

**CHANGE OF ACCOUNTING PERIOD**

Much confusion formerly resulted from the failure of the Act to provide a method whereby a corporation might change its accounting period. The only deductions necessary for this purpose are of dividends declared out of earnings already included in the measure of a tax upon the declaring corporation by this state under this Act or any other act. See *supra* note 15. Since it served no purpose to extend deductions to dividends from corporations not taxable under any act of this state, section 8 (h) was amended to eliminate such deductions. Inasmuch as Federal Reserve or other banks chartered by the federal government, doing business in this state, excepting national banks, are probably the only corporations not subject to taxation under article XIII of the constitution, the amendment was undoubtedly intended expressly to eliminate the deductions of dividends from such corporations.

A question might arise, however, whether this intention is frustrated by section 5 which defines "corporation" as including "every financial corporation other than a bank or banking association . . .," etc. "Bank" is defined in section 5 as including "national banking associations." These definitions specify the classes of corporations taxable under the Act, and have, therefore, no direct application to banks or corporations not taxable thereunder. As state and national banks are the only banks taxable under the Act there can be no apparent basis for holding that Federal Reserve or Federal Land Banks are "banks" and not "corporations" within the meaning of the Act. Since such banks are not in any event subject to taxation under the Act they would hardly be subject to the classification set up by the Act for taxation purposes. It would therefore seem that section 8 (h), by referring specifically to corporations not taxable under the Act, contemplated corporations in a generic sense and not in the special sense of section 5. The definition of Federal Reserve Bank contained in section 221 of title 12 of the United States Code demonstrates clearly that Federal Reserve Banks are neither national banks nor national banking associations, but that such banks constitute a separate and distinct class of corporations which are created under act of Congress. In other words, since Federal Reserve Banks are not state banks and are not banking associations the only generic term which could have been employed to distinguish them from state banks and national banking associations was the term "corporation."

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18 Cal. Stats. 1933, c. 209, p. 688.

19 The only deductions necessary for this purpose are of dividends declared out of earnings already included in the measure of a tax upon the declaring corporation by this state under this Act or any other act. See *supra* note 15. Since it served no purpose to extend deductions to dividends from corporations not taxable under any act of this state, section 8 (h) was amended to eliminate such deductions. Inasmuch as Federal Reserve or other banks chartered by the federal government, doing business in this state, excepting national banks, are probably the only corporations not subject to taxation under article XIII of the constitution, the amendment was undoubtedly intended expressly to eliminate the deductions of dividends from such corporations.

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20 See *supra* note 17.
period from fiscal year to calendar year, from calendar year to fiscal year or from one fiscal year to another fiscal year. The 1933 amendments provide in detail, substantially as in the Federal Revenue Act, for computing the tax in the event of such changes.\textsuperscript{21}

\textbf{Commencing Banks and Corporations}

The tax upon banks and corporations for any one year is usually measured by their net income for the preceding fiscal or calendar year. Since this measure obviously does not exist for the first year of a bank or corporation commencing business after the effective date of the Act, fairness to other banks and corporations demanded that some method be devised for measuring the tax in such cases. The Act has accordingly provided since its enactment that a commencing bank or corporation shall prepay the minimum tax of $25 and, following the close of the first taxable year, pay a tax credited with this prepayment and adjusted upon the basis of its net income for that year.\textsuperscript{22} Regardless of the date at which it commenced to do business, a bank or corporation must pay a tax measured by the net income of a period corresponding to that for which the privilege taxed is exercised.

The establishment of a measure appropriate to the first taxable year of a commencing bank or corporation did not, however, meet the problem of finding a measure for its second taxable year which would operate equitably in all cases. In its original form section 13 provided that the tax of a bank or corporation for its second taxable year should be based on its net income for its first taxable year. This application of the usual measure proved satisfactory where the first taxable year of a bank or corporation constituted a period of twelve months. Where, however, the first taxable year was a period of less than twelve months—which is often the case since most corporations keep their books either on a calendar year basis or on the basis of a fiscal year ending June 30th, and few corporations commence business on either January 1st, or July 1st—the bank or corporation was permitted to do business during its entire second taxable year, a full twelve-month period, by paying a tax measured by the net income of a fraction only of a year. An attempt was made in 1931 to correct this situation by amending section 13 to provide that the net income used as the measure of the tax for the second taxable year should bear the same ratio to the net income for the first taxable year as the twelve months in the second taxable year bear to the number of months covered by the return for the first taxable year. This resulted, however, in a tax for the second taxable

\textsuperscript{21} § 12 of the Act as amended by Cal. Stats. 1933, c. 210, p. 695.

\textsuperscript{22} Cal. Stats. 1929, c. 13, § 13, as amended by Cal. Stats. 1929, p. 1555; Cal. Stats. 1931, p. 65; Cal. Stats. 1933, c. 305, p. 869.
year measured partly by fictitious income. The 1931 amendment rested upon the assumption that since a bank or corporation received a certain net income for the fractional year in which it actually did business, it would have received the same income in each of the corresponding remaining fractions of the year if it had done business for a full twelve-month period. If, for example, a corporation's first taxable year covered the period from October 1st to December 31st—a quarter of a year—and its net income for that period were $500, the "net income" used as the measure of the tax for the second taxable year under the 1931 amendment was four times $500 or $2000. Actually there was no basis for assuming that this corporation would have earned as much income in each of the other three quarters as it did in the quarter of its actual earnings. Aside from its doubtful constitutionality, particularly with reference to banks, this computation was obviously inequitable in the case of corporations with a marked seasonal income.

The 1933 amendments to section 13 provide a method for computing the tax on commencing banks and corporations, for their first and second taxable years, which is not only workable but fair both to the state and to the banks and corporations. A bank or corporation must, as before, prepay the minimum tax upon commencing to do business in this state after the effective date of the Act. To insure collection of the minimum tax for the first taxable year, a provision has been added requiring the prepayment thereof to 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. Following the close of its first taxable year, its tax for that year is adjusted as before, upon the basis of its net income for that year, a credit being allowed for the prepayment of the minimum tax. In all cases where the first taxable year constitutes a period of twelve months the return for that year continues as the basis of the tax for the second taxable year.

Where the first taxable year is a period of twelve months the taxes for the first and second taxable years ordinarily will be in the same amount. Where, however, the law applicable to the period within which the second taxable year falls is different from the law applicable to the period within which the first taxable year falls, the taxes for the first and second taxable years will differ even though the returns for the first year are used as the basis of the tax for the second year. Thus, for example, the taxes for the first taxable year of corporations commencing in 1932 and reporting on a calendar year basis were measured at the rate of 4% by net income, in the computation of which a deduction for federal income taxes was allowed, and were subject to offset for local real and personal property taxes in accordance with the law applicable in 1932, whereas the taxes for the second taxable year were measured at the rate of 2% (in the case of corporations other than financial corporations) by net income computed without allowance of a deduction for federal income taxes and were not subject to offset in accordance with the law as amended in 1933. The same situation existed in the case of corporations commencing in 1932 and reporting on a fiscal year basis except that the taxes for the first taxable year

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23 Where the first taxable year is a period of twelve months the taxes for the first and second taxable years ordinarily will be in the same amount. Where, however, the law applicable to the period within which the second taxable year falls is different from the law applicable to the period within which the first taxable year falls, the taxes for the first and second taxable years will differ even though the returns for the first year are used as the basis of the tax for the second year. Thus, for example, the taxes for the first taxable year of corporations commencing in 1932 and reporting on a calendar year basis were measured at the rate of 4% by net income, in the computation of which a deduction for federal income taxes was allowed, and were subject to offset for local real and personal property taxes in accordance with the law applicable in 1932, whereas the taxes for the second taxable year were measured at the rate of 2% (in the case of corporations other than financial corporations) by net income computed without allowance of a deduction for federal income taxes and were not subject to offset in accordance with the law as amended in 1933. The same situation existed in the case of corporations commencing in 1932 and reporting on a fiscal year basis except that the taxes for the first taxable year
it constitutes a period of less than twelve months, however, the basis for the second taxable year now is the net income for the second taxable year, the only twelve-month period available as a measure of the tax. By thus measuring the tax for the second taxable year in all cases by the net income of a twelve-month period, the 1933 amendments avoid measures based on inadequate or partly fictitious income.

It may happen that a bank or corporation will realize less net income during its second taxable year than during its first taxable year, even though the latter constitutes a period of less than twelve months. In an endeavor to insure that in this event it will pay a tax for the second taxable year at least equal to the tax it would pay if its tax for that year were computed in the usual manner, i.e., upon the basis of the preceding year’s net income, the 1933 amendments provide that when the bank or corporation files its return and pays its tax for its first taxable year, it must also prepay on the tax for its second taxable year, an amount equal to the tax for its first taxable year.2 Once the return for the second taxable year is filed, and the tax based on the net income for that year is ascertained, credit is allowed for the prepayment, though provision is made that in no event shall the tax for the second taxable year be less than the prepayment.

It should be noted that banks or corporations which commence to do business pursuant to a reorganization or to a consolidation of two or more banks or corporations are specifically exempted from the above discussed provisions for reasons indicated later.3 With this exception these provisions apply to the computation of the tax for the first and second taxable year of all banks which locate or commence to do business and all corporations which commence to do business after the effective date of the Act.

A question may arise concerning the applicability of these provisions to banks and corporations which were existent but inactive between the effective date of the Act and the date—May 1, 1933—of the amended definition of “doing business.” Under the 1931 definition, a bank or corporation was considered to be doing business if it had the right to

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2 This provision fails to achieve the object sought when due to a change in the law the rates, deductions, etc., applicable to the computation of taxes for the second taxable year are different from those for the first taxable year. To achieve this object the law should be amended to provide that the tax for the second taxable year should not be less than it would be if computed—in accordance with the law applicable to the computation of taxes for the second taxable year—upon the basis of the return for the first taxable year.

3 See infra, p. 63.
do business, even though it engaged in no activities whatsoever. Under the 1933 amendments, however, section 5 defines "doing business" as "actively engaging in any transaction for the purpose of financial or pecuniary gain or profit." When a bank or corporation, in existence but inactive between the effective date of the Act and May 1, 1933, actively engages in business for the first time after the effective date of the Act, does it "commence" to do business on the theory that it was never before "doing business" after the effective date of the Act within the meaning of that term as now defined? Or does it simply resume "doing business," on the theory that under the 1931 definition it was "doing business," which it discontinued upon the repeal of that definition? If it "commenced" to do business in the year in which it actively engages in transactions for the purpose of financial or pecuniary gain or profit, its tax for that year will be measured by the net income for that year, and its tax for the succeeding year will be measured by the net income of the succeeding year, in accordance with the provisions of section 13 relative to commencing banks and corporations. If, however, it is regarded as "resuming" business, its tax for that year will be measured by the net income, if any, for the year in which it discontinued doing business, in accordance with the provisions of the Act discussed below, and the tax for the succeeding year will be measured by the income for the preceding year, in accordance with section 4 of the Act.

Section 5's definition of "doing business" as "actively engaging in any transaction for the purpose of financial or pecuniary gain or profit" must be followed in the rest of the Act. It must therefore be followed in the reference of the amended section 13 to a bank or corporation "which commences to do business in this State, after the effective date of this Act," and takes precedence over the earlier definition which has since been repealed. A logical construction of the Act would thus seem to justify the conclusion that a bank or corporation which engages in transactions for the purpose of financial or pecuniary gain or profit for the first time during any year after the effective date of the Act, should be regarded as commencing to do business during that year. Its tax for that year and the succeeding year should accordingly be computed under the provisions of section 13 of the Act relative to commencing banks and corporations.

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26 Cal. Stats. 1933, c. 210, p. 694. The reasons for the 1933 change in the definition of doing business are indicated in a previous installment of this article. (1933) 21 Cal. L. Rev. 550, 551.

27 See infra, p. 62.
Dissolutions, Withdrawals, Cessation of Business, Resumption of Business

Except in the case of a bank or corporation which discontinues business pursuant to a reorganization, consolidation or merger, no substantial change is made in the law with respect to banks or corporations discontinuing business and dissolving or withdrawing from the state during the same year. Such a bank or corporation pays no tax measured by the net income of the year of dissolution or withdrawal, and obtains an abatement or refund of its tax measured by the preceding year's income.

Where it does not so dissolve or withdraw, however, substantial changes have been made. The Act in 1931 provided that a bank or corporation in such a case was regarded as “doing business” merely by virtue of its “right to do business,” and therefore remained subject to the Act. If it had no net income after discontinuing business, however, it was not required to pay a tax for the succeeding year measured by the income of the year in which it discontinued operations, but paid only the annual minimum tax of $25 until its dissolution, withdrawal or resumption of operations. If it thereafter had net income, it would seemingly have been required to pay a tax for the succeeding year measured by the income of the year in which it discontinued operations, and to pay a tax in any subsequent year measured by the income of the preceding year, even though it actually engaged in no business activities.

The 1933 amendments specifically provide that a bank or corporation discontinuing the doing of business during any year and not dissolving nor withdrawing from the state, nor resuming the doing of business during the succeeding year, shall pay no tax for the succeeding year measured by the net income of the year in which it discontinued doing business, regardless of whether or not it thereafter has net income.

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28 See §13 of the Act as amended by Cal. Stats. 1931, c. 65, p. 65, and by Cal. Stats. 1933, c. 303, p. 872. Thus, for example, if a corporation reporting on a calendar year basis dissolves on June 30, 1935, it will pay no tax measured by the income for the period from January to June 30, 1935. This income could only be used as a measure of the tax for the year 1936 and since the corporation will no longer be in existence, it will not be required to pay a tax for 1936. Furthermore, the corporation will obtain a refund or an abatement of approximately half of the tax for the year 1935, measured by the income for the year 1934, inasmuch as the corporation exercised the privilege of doing business for only six months of the year 1935.

29 Cal. Stats. 1933, c. 303, p. 872.

30 For a discussion of the 1931 and 1933 amendments to the definition of the term “doing business,” see a previous installment of this article. (1933) 21 CALIF. L. REV. 550, 551.

31 §13 of the Act as amended by Cal. Stats. 1931, c. 65, p. 65.

32 Cal. Stats. 1933, c. 303, p. 875.
income. Where it resumes doing business, however, in some subsequent year, it must pay a tax measured by the net income of the year in which it discontinued business. Without this provision, it would have been required to pay only a $25 tax upon the resumption of business.

REORGANIZATIONS, CONSOLIDATIONS AND MERGERS

Until the 1933 amendments, the Act made no provision for reorganizations, consolidations, and mergers. Banks or corporations dissolving or withdrawing from the state in any year, even when pursuant to a reorganization, consolidation or merger, obtained an abatement or refund of the tax for that year measured by the net income for the preceding year. As a result a portion of the income for the preceding year escaped taxation; likewise the net income for the months of the year in which dissolution or withdrawal occurred did not become the measure of any tax imposed by the Act. A bank or corporation discontinues doing business on June 30, 1935. Its net income for 1934 was $10,000 and its net income for the first six months of 1935 was $5,000. If the corporation does not dissolve nor withdraw during 1935, its tax for the year 1935 will be measured by the net income for the year 1934 without any abatement or refund. If the corporation does not resume doing business during 1936 and does not dissolve nor withdraw during that year its tax for the year 1936 will be $25. Thus, no tax will be measured by the $5,000 of net income for the year 1935. If the corporation remains inactive in 1937, its tax for the year 1937 will be $25 regardless of whether or not it happened to have a net income for the year 1936. If the corporation resumes doing business in the year 1938 it must pay a tax measured by the $5,000 net income for the year 1935.

In the above example the most significant change is that under the new law the corporation, when it resumes business, must pay a tax measured by the income of the year in which it discontinued business, whereas, under the old law, when it resumed business, it would pay a $25 tax only, unless it had a net income during the preceding year in an amount sufficient to give rise to a greater tax. If, however, the corporation in the above example had realized net income during 1936, even though it did not actually do business, under the old law it would have had to pay a tax for 1936 measured by the net income of 1935, and in 1937 would have had to pay a tax measured by the net income of 1936. Under the new law, regardless of whether it has income or not in 1936, it pays no tax in 1936 measured by 1935 income and pays no tax in 1937 measured by 1936 income, if during these years it is inactive.

33 The method in which the change operates may be explained by the following example:

A corporation discontinues doing business on June 30, 1935. Its net income for 1934 was $10,000 and its net income for the first six months of 1935 was $5,000. If the corporation does not dissolve nor withdraw during 1935, its tax for the year 1935 will be measured by the net income for the year 1934 without any abatement or refund. If the corporation does not resume doing business during 1936 and does not dissolve nor withdraw during that year its tax for the year 1936 will be $25. Thus, no tax will be measured by the $5,000 of net income for the year 1935. If the corporation remains inactive in 1937, its tax for the year 1937 will be $25 regardless of whether or not it happened to have a net income for the year 1936. If the corporation resumes doing business in the year 1938 it must pay a tax measured by the $5,000 net income for the year 1935.

In the above example the most significant change is that under the new law the corporation, when it resumes business, must pay a tax measured by the income of the year in which it discontinued business, whereas, under the old law, when it resumed business, it would pay a $25 tax only, unless it had a net income during the preceding year in an amount sufficient to give rise to a greater tax. If, however, the corporation in the above example had realized net income during 1936, even though it did not actually do business, under the old law it would have had to pay a tax for 1936 measured by the net income of 1935, and in 1937 would have had to pay a tax measured by the net income of 1936. Under the new law, regardless of whether it has income or not in 1936, it pays no tax in 1936 measured by 1935 income and pays no tax in 1937 measured by 1936 income, if during these years it is inactive.

34 Section 13 defines reorganization as including: "(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." Cal. Stats. 1933, c. 303, p. 873.

35 Thus if a corporation earned $100,000 net income in 1932, and dissolved or withdrew from the state on June 30, 1933, its tax for 1933 would have been measured only by $50,000 net income.

36 Formerly the net income for the months of the year in which the dissolution or withdrawal occurred could be used only as the measure of a tax on the dissolving or withdrawing bank or corporation for the succeeding year. Since banks or corporations do not remain subject to the Act after they dissolve or withdraw from the state, this income escaped taxation.
poration which came into existence through reorganization or consolidation was considered as a commencing bank or corporation, and its tax liability for its first and second taxable years was computed on that basis.\textsuperscript{37} Thus, a change in the corporate structure of a business sufficed to change considerably the amount of taxes due.

As amended, section 13 of the Act\textsuperscript{38} provides that a bank or corporation which dissolves or withdraws from the state pursuant to a reorganization, consolidation or merger does not obtain an abatement or refund of the tax measured by the preceding year's income. Thus, all the income of the preceding year is used as the measure of a tax. Banks or corporations coming into existence pursuant to a reorganization or consolidation are not regarded as commencing banks or corporations and are not required to pay any tax for the first taxable year. For the second taxable year, however, they must pay a tax measured by their own net income for the first taxable year and the net income of the dissolving or withdrawing bank or corporation for the months of the year in which the reorganization or consolidation occurred. In case of a merger, the continuing bank or corporation must likewise pay a tax for the year succeeding the merger measured by its own net income for the preceding year and the net income of the merged banks or corporations for the months of the year prior to the merger. The 1933 amendments thus insure that taxes on a business will be measured by the same net income, regardless of changes in its corporate structure through reorganization, consolidation or merger.\textsuperscript{39}

\textsuperscript{37}See \textit{supra}, p. 59. A corporation which came into existence pursuant to a reorganization or a consolidation might have a net income for its first and second taxable years sufficient to produce greater taxes than would otherwise have been possible, even though the old corporation obtained an abatement or refund of its tax for the year of its dissolution or withdrawal, and was not required to pay a tax measured by the income of the months of the year prior to the dissolution or withdrawal. Where a merger occurred, however, the taxes were inevitably less than before, since the merged corporation would escape a tax measured by a portion of its income, and the continuing corporation not being regarded as a commencing corporation, would not have to pay additional taxes on that basis.

\textsuperscript{38}Cal. Stats. 1933, c. 303, p. 875.

\textsuperscript{39}The following examples illustrate how the amendments operate:

(1) Suppose \textit{A} corporation reporting on a calendar year basis has $500,000 net income for 1934 and $200,000 net income for 1935, half or $100,000 of which is earned in the first six months of 1935. Its tax for 1935 calculated on the basis of its net income for 1934 is $10,000 (2\% of $500,000). Its tax for 1936 computed on the basis of its net income for 1935 will be $4,000 (2\% of $200,000). Now suppose a reorganization occurs on June 30, 1935, pursuant to which \textit{X} corporation is organized and all of the assets of \textit{A} are transferred to \textit{X}. Even though \textit{A} ceases doing business in the state or dissolves or withdraws from the state during the year 1935 its tax for 1935 will not be subject to abatement or refund. Consequently its tax for 1935 will be $10,000. \textit{X} will not pay any tax for its first taxable year, but its tax for its second taxable year, the year 1936, if it reports on a calendar year basis, will be measured
CONSOLIDATED RETURNS

While the Act has always permitted the filing of consolidated returns, it failed to provide, until the 1933 amendments, any method of computing the tax in the event of such returns. The advantages of filing them were therefore precarious, in view of the provisions of sections 1, 2, 4 and 14 that "every" bank and "every" corporation should pay a tax according to or measured by "its" net income. The situation was aggravated in the case of banks or corporations commencing business as members of an affiliated group.  

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 1935 prior to the reorganization. Its tax for the year 1936 so computed will be $4,000. Thus, the taxes of the two corporations for the two years 1935 and 1936 will total $14,000, the amount A's taxes would have been had the reorganization not occurred.

(2) Suppose B corporation reporting on a calendar year basis, has a net income of $200,000 for 1934, and a net income of $400,000 for 1935, half or $200,000 of which is earned during the first six months of 1935. B's tax for 1935 will be $4,000 (2% of $200,000, the income earned during 1934) and for 1936 will be $8,000 (2% of $400,000, the income earned during 1935). Suppose A in example (1) above consolidated with B on June 30, 1935, forming Y corporation, and thereupon A and B dissolve or withdraw from the state prior to the close of the year 1935. The taxes of A and B for the year 1935 will be the same as they would have been had the consolidation not occurred, i.e., $10,000 and $4,000 respectively, or a total of $14,000. Y will pay no tax for its first taxable year, but its tax for its second taxable year, the year 1936, 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 for the last six months of 1935 and $200,000 from B's business for the last six months of 1935) and also by the $100,000 net income of A and the $200,000 net income of B for the months of the year 1935 prior to the consolidation, or $600,000 in all. Thus, its taxes for the year 1936 will be $12,000. The total of the taxes of the three corporations for the two years 1935 and 1936 will be $26,000. The combined taxes of A and B for the two years also would have totalled $26,000 if the consolidation had not occurred ($14,000, A's taxes plus $12,000, B's taxes).

(3) Suppose A merges into B on June 30, 1935, instead of consolidating with B and thereupon dissolves or withdraws from the state prior to the close of the year 1935. A's tax for the year 1935 will be $10,000 and B's tax for the year 1935 will be $4,000. B's tax for the year 1936 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 1935, and $400,000 of which represents the amount of net income B would have earned during the year 1935 had the merger not occurred), and also by the $100,000 net income of A for the months of the year 1935 prior to the merger. As so measured, its tax for the year 1936 will amount to $12,000. Thus, the taxes of the two corporations for the two years 1935 and 1936 will total $26,000, which is the same amount they would have been had the merger not occurred.

40 Under the statute as enacted in 1929 a consolidated return in lieu of separate returns could be made in the case of an affiliated group of banks or corporations, or one or more banks and one or more corporations. Cal. Stats. 1929, c. 13, § 14, p. 26. Such returns could be filed regardless of whether or not the affiliated group consisted only of banks, only of corporations, or of both banks and corporations. In 1931 the statute was amended to withdraw the right of a bank to file a consolidated return with a non-banking corporate member of the affiliation. Cal. Stats. 1931, c. 64, § 2, p. 63. The validity of this amendment is questioned and discussed in Traynor, op. cit. supra note 4, at 756-758.

41 See discussion of commencing corporations, ibid. at 754, 755.
As amended in 1933, section 14 provides that the tax shall be computed as a unit upon the consolidated net income of the group, and that the parent corporation and each subsidiary shall be severally liable therefor. Where a member of an affiliated group is a bank or corporation commencing business, its tax for its first and second taxable years must be computed, irrespective of the consolidated returns provision, in accordance with section 13; the tax of the other members of the group, for the year succeeding the year in which such bank or corporation commenced to do business, must be computed as if such bank or corporation were not a member of the affiliated group. The income and losses of a commencing bank or corporation accordingly do not enter into the computation of the group tax until its third taxable year. Finally, section 14 as amended takes away the privilege of filing consolidated returns when at least 95% of the stock of each member of an affiliated group is owned "by the same interests." An identical provision in the earlier federal revenue acts was removed in 1928. The change in the state, as in the federal, statute arose from the difficulty of determining what constitutes the "same interests."

Problems still existing under section 14 arise largely from the difficulties of determining what constitutes an affiliated group. The Act prescribes three requisites for the filing of consolidated returns by an affiliated group: (1) the members of the group must be connected through stock ownership with a common parent corporation; (2) at least 95% of the stock of each of the corporations, except the common parent corporation, must be owned directly by one or more of the other corporations; and (3) the common parent corporation must own directly at least 95% of the stock of at least one of the other corporations.

42 Cal. Stats. 1933, c. 209, p. 690.
43 Inasmuch as the tax for the first taxable year of a commencing corporation is computed upon the basis of the income earned during that year, and similarly for the second taxable year upon the basis of the second taxable year's income if the first taxable year is a period of less than twelve months, whereas the tax for other corporations is computed upon the basis of the preceding year's income, there could be no adequate basis for consolidated returns until the tax for all members of the group could be measured by income for the same periods. In view of the fact that the tax of commencing corporations whose first taxable year is a period of less than twelve months cannot be measured by a preceding year's income until the third taxable year, the inclusion of the income of such corporations in the measure of a tax on the group could not be permitted until the computation of the tax for the third taxable year. The income of commencing corporations choosing a first taxable year of twelve months could have been included in the measure of the tax on the group for the second taxable year had the legislature so desired, but it was apparently deemed less confusing to provide in all cases that not until the computation of the tax for the third taxable year could the income of commencing corporations be included in the measure of the tax on the group.
The question has arisen whether an affiliated group, as defined in section 14, may include corporations not taxable under the Act. Section 14 does not specifically require that the corporations in an affiliated group should thus be taxable. However, only banks and corporations that are doing business in California, or that were subject to be taxed under section 14 (d) of article XIII, are taxable under the Act. The provision of section 13, therefore, that every bank and every corporation shall file a return, and of section 14 that consolidated returns shall be permitted in lieu of separate returns can apply only to corporations that are doing business in California or that were subject to tax under section 14 (d). Since all other corporations are non-taxable, and therefore not subject to the Act, it follows that they are not subject to section 14 or any other section. Since they cannot file any return under the Act, they cannot join in filing a consolidated return. The tax upon corporations filing consolidated returns must be computed as a unit, and both the parent corporation and each subsidiary are severally liable therefor. It follows that the income of all members of an affiliated group must be included in the measure of the tax computed as a unit, and that the members themselves must be taxable corporations in order to be severally liable for the tax. An affiliated group having the privilege of filing consolidated returns does not exist under the Act if the common parent corporation or any essential subsidiary is non-taxable, even though the non-taxable corporations may be as closely connected through stock ownership with the common parent and with each taxable subsidiary, as the latter are connected with each other.

44 See opinion of Attorney General Webb, No. 9113, per H. H. Linney, Deputy.
45 Income of non-taxable corporations can not be included in the measure of the tax on the entire group. Nor can non-taxable corporations be made severally liable for the tax so computed. It would of course be advantageous to a group if it could reduce its taxes by virtue of the losses of non-taxable corporations affiliated with it. But it would be no more legitimate to allow the offset of such losses in the computation of a unit tax than it would be to tax non-taxable income. For example, suppose A, a foreign corporation not taxable under the Act, owns all the stock of B and C who are taxable under the Act. To allow a consolidated return by A, B, and C would either subject to taxation the income of A, which is not taxable under the Act, or would allow the losses of A from business done outside of California to be offset against the taxable income of B and C. To allow a consolidated return by B and C alone, excluding the income or losses of the parent corporation A, would render meaningless the requisite of a common parent corporation in an affiliated group.

If, however, A were the parent corporation of B, and B, a domestic, taxable corporation, were the parent corporation of C and D, subsidiary domestic and taxable corporations, B, C, and D could meet the requisites for the filing of consolidated returns by an affiliated group by regarding B as the parent corporation, and excluding the income or losses of A from their consolidated return.

If again A were the parent corporation of B, B the parent corporation of C and D, and D the parent corporation of X (a non-taxable corporation), B, C and D
FINANCIAL CORPORATIONS CANNOT FILE CONSOLIDATED RETURNS WITH MERCANTILE, MANUFACTURING AND BUSINESS CORPORATIONS

The Act clearly differentiates financial from mercantile, manufacturing and business corporations; it imposes different rates upon the two groups and grants only to financial corporations a limited offset for personal property taxes. This differentiation, as the earlier instalments of this article brought out, was devised expressly to insure the validity of the bank tax, with reference to section 5219, by precluding the imposition of a higher tax on national banks than on other financial corporations. The legislature, in devising it for that restricted purpose, could not have intelligently contemplated any breach in its observance which would lower the tax on financial corporations below that of banks and thereby invalidate the tax on national banks.

The Act does not permit banks to file consolidated returns with corporations other than banks; it thereby enjoins them from deducting from their gross income the losses of affiliated mercantile, manufacturing or business corporations. To accord this privilege to financial corporations would be deliberately to invalidate the tax on national banks. The question arises, however, whether the legislature has unintentionally left the way open for this result. Section 14 fails to distinguish between financial and non-financial corporations; it refers throughout to "corporations," which are defined in section 5 to include "every financial corporation." This omission, clearly an oversight, will un-

could again meet the requisites for the filing of consolidated returns by an affiliated group by regarding B as the common parent corporation and C and D as the subsidiaries of a taxable group, and excluding the income or losses of non-taxable A and non-taxable X from their consolidated returns.

Although consolidated returns are designed to tax as a business unit what is, in reality, a business unit, and although A and X are just as integral a part of the business unit as B, C and D, they have neither the privilege nor are they under the compulsion of joining in a consolidated return with the taxable members of the business unit. Conversely, the taxable members of the business unit, if they fulfill the requisites of an affiliated group for the purpose of filing consolidated returns, cannot be denied the right to consolidate because of the non-taxability of A and X.

46 In the period between the 1931 and 1933 amendments to section 14 (see supra note 40) banks were enjoined from filing consolidated returns with any type of corporation while financial corporations were apparently accorded that privilege. It might be contended, therefore, that since banks retained the privilege of filing consolidated returns with any type of corporation, until it was taken away in 1931, financial corporations retain a similar privilege until it is similarly taken from them. This contention, however, assumes that there is no other way of making this privilege unavailable either to banks or financial corporations. If banks had not lost this privilege under the 1931 amendments they would in any event have lost it by virtue of the differentiated rates established by the 1933 amendments. This differentiation makes it impossible to find a common rate at which either banks or financial corporations could file consolidated returns with mercantile, manufacturing, and business corporations. The unavailability of that privilege is confirmed as to banks by the 1931 amendments and is confirmed as to financial corporations by the clear purpose of the 1933 amendments.
doubtedly be subject to legislative correction. Pending correction, however, would a literal construction of these provisions warrant the assumption that financial and non-financial corporations could unite, regardless of the rest of the Act and regardless of consequences, in filing consolidated returns? Had these sections really extended such a privilege, they would necessarily have provided some explicit means of exercising it. Their failure to provide a rate at which differentiated corporations could make consolidated returns amounts to a recognition that the differentiation precludes consolidation, and makes it even clearer that the legislature, in these sections, was guilty only of a remediable oversight and not of an intention to invalidate its own act.

How could one compute a tax upon the consolidated net income of a group of financial and non-financial corporations? If section 14 appears at first glance to have extended the necessary keys, it soon develops that the keys do not fit the lock, and that no password has been suggested. In providing that the tax "shall be computed as a unit upon the consolidated net income of the group" it precludes the possibility—assuming that accounting obstacles could be overcome—of apportioning the consolidated net income according to the differentiated rates. To subject the whole group to one rate applicable to only one class of corporations therein would seem clearly to violate the provisions of the Act establishing a different rate for the other class of corporations. Even if one rate could be applied, which rate would it be? The difficulties in the way of determining whether the group were financial or non-financial seem insurmountable. How, for example, could a group of corporations, some of which are definitely financial, and some of which are definitely mercantile, manufacturing or business, be regarded either as a financial corporation or as a mercantile, manufacturing or business corporation? Even if the rate of one group were arbitrarily applied to the other, fresh difficulties would be presented by the restriction of the personal property tax offset to financial corporations.47 There is no magic by which the necessity of

47 Attempts to meet these difficulties, under existing statutory provisions, would lead to confusion and a choice between undesirable alternatives. The possible alternatives are: (1) To apply the financial corporation rate and allow an offset for the personal property taxes (a) of all corporations, (b) of only the financial members of the group, (c) of only the mercantile, manufacturing, or business corporations, or (d) of none of the corporations; or (2) to apply the business corporation rate and allow the offset as in (a), (b), (c), and (d) above.

Alternative (1) (a) would seem clearly to violate the express purposes of the 1933 amendment to section 26 restricting the offset to the personal property taxes of financial corporations. Alternative (1) (b) seems unjust inasmuch as the tax at the financial corporation rate would be measured by the income of all of the corporations. The disallowance of offset for the personal property taxes of some of the members on the ground that they are not financial corporations would be incon-
Oil and water cannot be mixed by the simple device of calling them by the same name.

The clear distinction between financial and non-financial corporations, implicit in the Act's purpose, and explicit in its differentiated tax rates, thus frustrates any attempt to read into section 14 an intention to disregard that distinction. One cannot find in either the Act as a whole, or in section 14 isolated therefrom, any means enabling financial corporations to file consolidated returns with differentiated corporations. Those sections, therefore, requiring "every corporation" to file a return and imposing the rate applicable to financial corporations or mercantile, manufacturing or business corporations, as the case may be, remain operative.

**Time When Taxes Are Payable**

No change has been made in the time when the taxes on mercantile, manufacturing and business corporations are due and payable. Such corporations are required, on filing their return within two months and fifteen days after the close of their fiscal or calendar year, to pay one-half of the tax disclosed thereby, and the balance within six months thereafter.
The 1933 amendments provide that banks and financial corporations, however, on filing their returns within two months and fifteen days after the close of their fiscal or calendar year, must pay a tax at the rate of 2% of their net income.50 By determining the percentage of the net income of mercantile, manufacturing and business corporations paid or required to be paid in personal property taxes during the preceding fiscal or calendar year, and the percentage of the net income of such preceding fiscal or calendar year exacted as a franchise tax, the Franchise Tax Commissioner can accordingly determine the rate applicable to banks and financial corporations. Section 4a51 provides that this rate must be determined not later than the thirty-first day of December of each year after public hearing and an opportunity of examining the data upon which the rate is based. Within fifteen days after the mailing of notice of the determination of the rate to be paid by banks and financial corporations, the difference between the amount paid by them upon filing their returns and the total amount required of them is due and payable.

**DEFICIENCY ASSESSMENTS, APPEALS TO THE BOARD AND REFUNDS**

The Act formerly provided that in the case of deficiency assessments the taxpayer could protest payment of the tax to the commissioner and, if the protest were overruled, could either appeal to the State Board of Equalization or pay the tax under protest and bring an action for refund.52 After a decision by the board, either the commissioner or the taxpayer could institute a new action in the superior court, where the case was entirely retried, thus rendering meaningless the hearings, findings and decision of the board. The 1933 amendments, while leaving the preliminary steps unchanged, provide that if the taxpayer elects to appeal to the board, he may not thereafter bring an action in the superior court for refund in the event of an adverse decision, but must appeal to the supreme court of the state for a writ of

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50 § 23 as amended by Cal. Stats. 1933, c. 303, p. 875.
51 Cal. Stats. 1933, c. 303, p. 872.
52 See §§ 25 and 27, Cal. Stats. 1929, c. 13, pp. 29, 30; Cal. Stats. 1931, c. 1066, p. 2225.
Likewise if the board reverses the commissioner, he has recourse only in an appeal to the supreme court.

Heretofore an appeal could be taken from the commissioner to the board only in the case of a deficiency assessment. Where an overpayment of the tax was made, and a claim for refund filed with the commissioner was denied, the only remedy left the taxpayer was to sue for recovery in the superior court. Under the 1933 amendments, it may either sue for recovery or appeal to the board. In the latter case, the board's decision is final unless a writ of certiorari or review is obtained from the supreme court.

Before 1933, there was no provision for crediting overpayments on taxes due the state. The full amount of the overpayment had to be refunded in all cases. The 1933 amendments provide that overpayments shall first be credited on taxes due the state, and the balance only shall be refunded to the taxpayer. Further, the period for making additional assessments and for claiming refunds has been extended from one to three years.

Lien of the Tax

Attachment of the lien coincidentally with accrual of the tax is desirable from the standpoint of both state and taxpayers. To impose a lien before the tax obligation has accrued unduly burdens taxpayers and purchasers from them; to impose it after accrual leaves the interests of the state insufficiently protected. A uniform lien date, therefore, requires a correspondingly uniform accrual date just as varying accrual dates demand corresponding dates for the attachment of the lien.

Notwithstanding these basic propositions the Act has provided since its enactment for a uniform lien date, the first Monday in March of each year, and varying accrual dates. January 1st is the accrual date for corporations making returns on a calendar year basis; the first day of any of the other eleven months, as the case may be, is the accrual date for fiscal year corporations. The constitutional provision in pursuance of which the Act was passed compelled the uniform lien date; a desire to avoid needless expense and inconvenience brought about the varying accrual dates.

It is difficult to understand what object the framers of the constitutional provision hoped to serve by fixing in the constitution a uniform

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53 § 30 as amended by Cal. Stats. 1933, c. 210, p. 703.
54 § 27 as amended by Cal. Stats. 1933, c. 210, p. 701.
55 Ibid.
57 Cal. Stats. 1929, c. 13, §29, p. 31, as amended by Cal. Stats. 1933, c. 210, p. 703.
58 Cal. Stats. 1929, c. 13, §4, p. 20, as amended by Cal. Stats. 1933, c. 303, p. 870.
59 CAL. CONST. (1928) art. XIII, § 16 (b).
lien date for all corporations. Perhaps it was their intention to compel all corporations to file returns on the same basis regardless of the fiscal periods on which their books are kept. It is believed, however, that the lien was fixed in the constitutional provision as of the first Monday in March simply because that has been the customary lien date in this state for general property taxes, including the gross receipts tax on public utilities, the gross premiums tax on insurance companies and the franchise tax for which the according to or measured by net income tax was substituted, and that it was not intended to prescribe the particular annual periods for which the tax liability was imposed.\footnote{Although section 16 of article XIII specified that the banks and corporations taxable thereunder should “annually” pay the tax imposed, it did not specifically provide that the tax should be for any particular twelve-month period. Furthermore, although it provided that the tax should be measured by net income, it did not specify the net income of any particular period. In this connection, it is to be contrasted with section 14 (f) of article XIII, which specifically provided that the gross receipts and gross premiums tax imposed upon public utilities and insurance companies, respectively, should be computed upon the basis of gross receipts and gross premiums for the year ending the thirty-first day of December prior to the levy of such taxes. Finally, it is to be observed that section 16 authorized the legislature to provide “for the assessment, levy and collection” of the tax imposed thereby and to “pass laws necessary to carry out this section.” These provisions would seem clearly to permit the legislature to prescribe the period upon the basis of which the net income to be used as the measure of the tax should be computed, and the period for which the tax should be paid.}

In providing for varying accrual dates, the legislature, apparently being unwilling to compel taxpayers to change or supplement their systems of accounting by a single fixed accrual date, followed the federal practice permitting accruals and the filing of returns according to the fiscal or calendar year periods employed by the taxpayers in keeping their books of account. To provide a uniform accrual date coincident with the first Monday in March and to require all returns to be made on that basis would be not only unduly burdensome to corporations but would prevent, in many cases, the use of federal returns as a basis for making returns to the state, thus greatly complicating the administration of the Act.

The legislature’s attempt, however, in the face of a given uniform lien date, to provide convenient and workable methods of computing the tax and making returns, raised a serious question as to when the lien attached for taxes accruing after the first Monday in March of any year. Did the lien in such cases attach in the March prior to or the March succeeding their accrual? The statute left this important question unanswered.

As indicated above, the desirable solution would have been to have the lien attach coincidently with accrual of the tax.
constitutional provision, however, the legislature could not change the lien date. The only thing it could do to clarify the situation, without abandoning the provisions for filing returns and computing the tax on the basis of the taxpayer's system of accounting, was to indicate which first Monday in March it believed the constitution intended that taxes for corporations reporting on a fiscal year basis should become a lien. In 1933, the legislature, in attempting to remove this uncertainty, provided that the lien should attach on the first Monday in March of the calendar year in which the tax accrues.\(^6\)

Under the Act as it now reads the lien will not attach until at least two months after the tax accrues in the case of all calendar year corporations, and at least one month thereafter in the case of fiscal year corporations whose taxable years end on January 31st. Within those months the property of such taxpayers may apparently be sold free of the lien. If, however, the first Monday in the March following the accrual had been chosen, there would have been no difference with respect to the above corporations but all fiscal year corporations whose taxable years ended after the first Monday in March would have had from the first day after the close of such taxable years until the following first Monday in March to sell their property free of the lien. Inasmuch as there are many such corporations, the date chosen, if valid, undoubtedly affords the greater protection to the interests of the state.

Doubts about the validity of the new provision arise from the fact that the lien will attach before the tax is due or can be computed or before any tax obligation arises in the case of corporations whose taxes accrue subsequent to the first Monday in March. Attachment of the lien for taxes before they are due or can be computed is a usual occurrence in this state. In the case of county taxes on property, the lien attaches in March\(^6\) whereas the tax may not be computed until the following September.\(^6\) In the case of state taxes, e. g., taxes on gross receipts and gross premiums, the taxes may not be computed until

\(^6\) § 29 of the Act as amended by Cal. Stats. 1933, c. 210, p. 703. An exception is made for banks or corporations commencing business in the state after the first Monday in March, whose first taxable year ends in the same calendar year in which they commence business. The lien here attaches on the first Monday in March subsequent to the time they commence to do business. This prevents the attachment of the lien before the taxpayers are in existence or within the jurisdiction of the state. The exception is not likely to operate frequently inasmuch as all but 8% of the corporations taxable under the Act do business on a calendar year basis. Since the first taxable year of commencing corporations electing such a basis will close December 31st, the tax for such period will accrue January 1st, and the lien therefor will attach the following March. The first taxable year of many fiscal year corporations will likewise probably end in the calendar year following that in which they commence business.

\(^6\) CAL. POL. CODE §§ 3717, 3718.

\(^6\) Ibid. § 3714.
July. The validity of this system was upheld in *Estate of Backestoo* wherein the court declared: "In this state the time when taxes shall attach as a lien upon property is fixed by statute as of a certain day in the year, and when the amount is ascertained it relates back to the time so fixed." In all the instances mentioned, however, the tax obligation exists on the first Monday in March even though the exact amount thereof can not be ascertained until later, whereas under the Bank and Corporation Franchise Tax Act, the tax obligation apparently does not arise until the time the tax accrues, i.e., on the first day after the close of the taxable year. Some support for the contention that the lien cannot constitutionally attach before the tax accrues may be found in the case of *East Bay Municipal Utility District v. Garrison*. This case held that a municipal utility district which did not exist on the first Monday in March of a particular year could not, when formed thereafter, create an obligation which would support a tax lien attaching as of that date. In the course of the opinion the court declared:

"In order, therefore, for the lien of taxes to be legally imposed upon property as of the first Monday in March of any particular year, it is essential to the fixation of such tax lien upon such property as of said date not only that the property itself should be in existence at the time of the attachment of such lien but also that there should be at such time an existing obligation to pay the particular tax which the lien thus imposed is to secure. Otherwise the lien would have no foundation upon which to rest and would, by the imposition of an encumbrance having no obligation to support it, amount to the taking to the extent of such encumbrance of the property of the citizen without due process of law."

It should be observed, however, that in this case the tax levying body was not in existence on the lien date. It was impossible for purchasers buying property from taxpayers subsequent to the lien date and prior to the levy of the tax to know that the property purchased was subject to a lien for a tax not yet imposed. It would not be reasonable to hold that innocent purchasers for value acquired property subject to a claim for taxes when there was no possible way in which they could know of such claim at the time of purchase. Purchasers from banks and corporations taxable under the Bank and Corporation Franchise Tax Act, however, are put on notice by the plain terms of the Act that property purchased on or after the first Monday in March of any year will be subject to the state’s claim for any taxes accruing against the bank or corporation during that year.

If it is permissible to provide that purchasers of property after a certain date shall acquire the property subject to the claims of the

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64 Ibid. § 3668.
65 (1923) 63 Cal. App. 265, 218 Pac. 597.
66 (1923) 191 Cal. 680, 218 Pac. 43.
67 Ibid. at 692, 218 Pac. at 47.
state for taxes which are neither due, assessed, nor ascertainable in amount as of that date, is it not equally permissible to provide that purchasers shall acquire the property subject to the claims of the state for taxes which will become due unless the taxpayer should go out of existence before the beginning of the period for which the taxes are imposed? The only difference between the two cases is that in one there is certainty that taxes in an uncertain amount will become due, while in the other there is a possibility that no taxes will become due. Certainly, it would seem that the need for protecting the interests of the state may be just as great in one case as in the other and that there should be no appreciable difference in the amount of hardship imposed.

Fortunately, section 16 of article XIII, as amended June 27, 1933, no longer prescribes a uniform lien date. The legislature is now free to remove the objectionable features of the lien provision by providing that attachment of the lien be coincident with accrual of the tax.

Is the lien for franchise taxes superior to pre-existing encumbrances, such as mortgage liens? This question is not specifically answered by statute and has not received judicial consideration. It is believed, however, that the answer is to be found in the cases construing the provisions of section 3716 of the Political Code relating to the lien of general property taxes. This section provides that “Every tax has the effect of a judgment against the person, and every lien created by this title has the force and effect of an execution duly levied against all property of the delinquent; the judgment is not satisfied nor the lien removed until the taxes are paid or the property sold for the payment thereof.”

Section 29 of the Act contains a practically identical provision: “Every tax herein provided for has the effect of a judgment against the taxpayer, and every lien has the effect of an execution duly levied against all property of the delinquent, and the judgment is not satisfied nor the lien removed until the tax and the penalty are paid, or the property sold for the payment thereof.”

In California Loan & Trust Co. v. Wels (1897) 118 Cal. 489, 495, 50 Pac. 697, 700, it was held that the lien of personal property taxes was superior to a mortgage lien existing at the time the tax lien attached. In the course of its opinion, the court, after pointing out that “the laws of our state put all tax liens upon an equality and make each and all superior to any other charge upon the land” and that “no doubt can be entertained but that this is the true and only reasonable interpretation of the effect of our code provisions,” stated: “It is held in Eaton’s Appeal, 83 Pa. St. 152, that a statute which declares that a tax shall continue a lien ‘until fully paid and discharged’ ex proprio vigore makes the lien superior to that of a judgment obtained before the tax is levied. In this state we not only have language of similar import in section 2716 [sic 3716] of the Political Code, but that language is aided so as to remove the need of interpretation by section 3788, which provides that the deed conveys the absolute title free from all encumbrances.” 118 Cal. at 495, 50 Pac. at 700.

Although section 3788 at that time specifically provided that a deed for property sold at a tax sale conveyed the property free of all encumbrances, it is apparent that the court regarded this section as simply aiding its construction of section 3716, and not as being essential to its conclusion. Any possible doubt on this matter is removed by the fact that although the above mentioned provision of section 3788 was omitted from the section in 1895 (Cal. Stats. 1895, pp. 20, 325), the courts have subsequently cited this case as authority for the proposition that the lien of property taxes is paramount to pre-existing encumbrances. German Sav., etc., Soc. v. Ramish (1902) 138 Cal. 120, 125, 69 Pac. 99, 92; Chase v. Trout (1905) 146 Cal.
COLLECTION PROCEDURE

Since its enactment the Act has authorized the State Controller to bring an action in a court of competent jurisdiction in the County of Sacramento to collect delinquent taxes and penalties.69 The 1933 amendments provide70 that the action shall be tried in the County of Sacramento unless the court, with the consent of the Attorney General, orders a change of place of trial. A similar amendment was made in 1931 to section 3668 of the Political Code which authorized the bringing of actions in Sacramento County to collect other delinquent state taxes.71 Without such a provision the defendant could have the place of trial changed to the county of its residence,72 thereby practically nullifying the advantage to the state of the provisions authorizing actions to be instituted in Sacramento County.

Prior to 1933 a one year period of limitation was provided for actions to collect delinquent taxes.73 This period, like the period for additional assessments and suits for refund,74 was extended to three years by the 1933 amendments.75

Until 1933, the bringing of an action by the State Controller was the only procedure authorized for the collection of delinquent taxes. This procedure needlessly delayed and increased the cost of collecting such taxes. The 1933 amendments added provisions patterned after section 3821 of the Political Code authorizing the Controller, within three years after the delinquency of any tax, to seize and sell sufficient real or personal property of the delinquent taxpayer to pay the tax together with interest, penalties and costs.76

REVIVOR OF CORPORATIONS

As originally enacted, the Act provided that if any taxes imposed by the Act were not paid by six o'clock P.M. of the last day of the twelfth month after the due date thereof, the corporate powers, rights and privileges of the delinquent taxpayer should be suspended in case it were a 350, 365, 80 Pac. 81, 87; Webster v. Board of Regents (1912) 163 Cal. 705, 709, 126 Pac. 974, 976; Guinn v. McReynolds (1918) 177 Cal. 230, 233, 170 Pac. 421, 422; Woodill & Hulse Elec. Co. v. Young (1919) 180 Cal. 667, 670, 112 Pac. 422, 423.

In view of the similarity between section 3716 of the Political Code and section 29 of the Act, it would seem that they should be construed alike. It follows, accordingly, that the lien of the taxes imposed by the Act, like the lien of general property taxes, is superior to pre-existing encumbrances such as mortgage liens.

69 Cal. Stats. 1929, c. 13, § 31, p. 32.
70 Cal. Stats. 1933, c. 210, p. 705.
71 Cal. Stats. 1931, c. 603, p. 1302.
72 People v. Pinches (1931) 214 Cal. 177, 4 P. (2d) 771.
73 Cal. Stats. 1929, c. 13, § 31, p. 32.
74 See supra, p. 71.
75 See supra, p. 71.
76 Ibid.
domestic corporation, and its right to do intrastate business should be forfeited in case it were a foreign corporation. In 1931 this period was shortened to eleven months.

Prior to 1933 a corporation so suspended could be revived by paying only the taxes, plus interest and penalties thereon, for the non-payment of which it was suspended, if payment were made in the year in which it was suspended. If payment were made in any other year, revivor could be made by paying the above amounts, plus an amount equal to twice the tax due for the year in which suspension occurred. Under these provisions, a corporation could revive without paying all the taxes due under the Act. For example, it could revive without paying deficiency assessments levied after suspension, and, if it revived during the year in which it was suspended, without paying the taxes due for that year. Furthermore, these provisions were objectionable in that the penalty for reviving in any year other than the year in which suspension occurred bore no relation to the taxes for the non-payment of which suspension occurred.

The 1933 amendments provide that a corporation in order to revive during the year in which suspension occurred must pay not only the tax, plus penalties and interest thereon, for the non-payment of which it was suspended, but also must pay all other taxes, penalties and interest due under the Act. If revivor is made in any other year, it must pay all the above amounts, plus a penalty for revivor, in an amount equal to the tax and penalties for the non-payment of which it was suspended.

Suppose A and B corporations were suspended in 1931 for non-payment of 1930 taxes due from them in the amounts of $25 and $1,000, respectively. Suppose further that A's tax for 1931 amounted to $1000 and B's tax for that year amounted to $25. Under the old provisions, although B was suspended for the non-payment of a much larger tax than A, B could revive in 1932 by paying its 1930 tax, together with interest and penalties thereon, plus a $50 penalty for revivor (twice the tax for 1931, the year it was suspended), whereas A was required to pay its 1930 tax, together with interest and penalties thereon, plus a $2000 penalty for revivor. These provisions thus operated harshly and inequitably.

Thus, if a corporation is suspended in 1935 for non-payment of its 1934 tax, it may be revived in 1935, by paying the 1934 tax, plus interest and penalties thereon, together with that part of the 1935 tax which has become due, plus interest and penalties thereon. If only the first installment of the 1935 tax has become due, only that installment need be paid. If the corporation desires to be revived in 1936, it must pay the 1934 tax, plus interest and penalties thereon, an amount equal to the 1934 tax, plus interest and penalties thereon, the 1935 tax, plus interest and penalties, and that part of the 1936 tax which has become due, plus interest and penalties thereon.