

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 351

December 15, 1972

RESERVE FOR BAD DEBTS ON LOANS FOR LOW AND MODERATE INCOME HOUSING

Syllabus:

After the statutory termination of deductions for the special reserve for bad debts allowed on loans for low and moderate income housing, the existing reserve may be continued on loans remaining outstanding, subject to the limitation of a maximum of ten percent.

Subdivision 24348(c) was added to the bad debts deductions section of the Bank and Corporation Tax Law in 1968. It authorizes a special bad debt deduction for financial institutions with respect to loans secured by residential property owned by low and moderate income families. The deduction authorized is for an addition to a reserve in the amount of two percent of the loans made, provided that the reserve cannot exceed, at the end of any income year, ten percent of the loans outstanding. Subdivision (c) specifies that the deduction is not applicable to loans made on or before December 31, 1968, and is applicable only to income years beginning on or after January 1, 1969. Statutes 1968, Chapter 1462, which added subdivision (c), as amended by Statutes 1970, Chapter 1239, specifies that the subdivision should remain in effect for income years commencing prior to December 31, 1971, and should have no force or effect after that date. There have been no further extensions of the time provisions, and neither has subdivision (c) been actually repealed.

The question is asked as to the treatment or disposition applicable to the reserve after 1971, since the statute makes no provision for this eventuality after the statute loses its force and effect. Nor does there appear to be any other expression of intention either at the time the statute was originally enacted or at the time of its amendment. Accordingly, we must attempt to construe such intention.

In our opinion, the most appropriate treatment and disposition is to retain the loans in a separate category, and also to retain the special reserve against these loans. The reserve would be allowed to remain at an amount not to exceed ten percent of the outstanding balance of the loans, as is specified in subdivision (c). Any excess in the reserve at the end of the income year would be required to be restored to income for such year.

This solution is reasonable and is in accord with the intent of the statute. Inasmuch as subdivision (c) has not been repealed, but remains in the law, a

basis is thereby provided for the conclusion that the loans and the reserve should continue to be recognized as long as the loans are in existence. The time limitation provided terminates only the allowance of the special deduction for an addition to the reserve for such loans, and need not be construed to terminate the recognition of existing loans or their accrued reserve. The higher risk of loss attendant upon these loans as inherently recognized in the special statutory provisions, certainly continues as long as the loans are outstanding. This factor should be of primary importance in construing the intent of the statute.

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