BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
UNION OIL ASSOCIATES)

Appearances:

For Appellant: L. W. Andrews of Andrews & Andrews & Paul M. Gregg, Attorneys, and John McPeak, Secretary of Union Oil Company of California
For Respondent: Chas. J. McColgan, Franchise Tax Commissioner

O P I N I O N

This is an appeal pursuant to Section 25 of the Bank and Corporation Franchise Tax Act (Stats. 1929, Chapter 13, as amended) from the action of the Franchise Tax Commissioner in overruling the protest of Union Oil Associates, a corporation, against a proposed assessment of additional tax in the amount of $44,552.63 based upon Appellant's net income for the calendar year ended December 31, 1930.

The Appellant, a California corporation, was organized for the purpose of acquiring and holding stock of the Union Oil Company of California, also a California corporation. -For each share of stock of the Union Oil Company acquired by it, the Appellant issued in exchange one share of its own stock. During the year 1930, the Appellant received from the Union Oil Company, on account of the stock held by it, $4,872,864 in dividends, 29.643976% of this amount being paid out of income from business done by the Union Oil Company outside the State of California. Appellant also received during the year 1930 stock transfer fees in the amount of $1,749.50, thus resulting in a total gross income of $4,874,613.50 for the year 1930.

The Bank and Corporation Franchise Tax Act, passed to carry into effect the provisions of Section 16 of Article XIII of the, Constitution of the State of California, provides that upon "every financial, mercantile, manufacturing and business corporation doing business within this state" (see Section 4), subject to taxation under Section 14(d) of Article XIII of the Constitution prior to the adoption of Section 16 of Article XIII, there shall be imposed a tax measured by its net income for the preceding taxable year. In the case of a corporation commencing to do business in this State for the first time, there is the exception that the tax for the first taxable year is measured by the net income of that year, and the tax for the second taxable year is measured by the net income for the first taxable year increased in the same proportion as the number of months in the second taxable year bears to the number of months in the first taxable year (Section 13).

Net income for the purpose of the Act is defined as being gross income less the deductions allowed (Section 7). Section 8(h) of the Act provides that from gross income there shall be deducted dividends received from income arising out Of business done in this State. Presumably, the purpose of this provision is to avoid double taxation since income arising out of business done in this State will be employed in computing a tax imposed on the corporation earning the income. But the Act makes no provision for the deduction of dividends received from income arising out of business done outside this State. The inclusion of such dividends will not result in double taxation, insofar as California is concerned, because income arising out of business done outside this State is not employed in computing a tax imposed on the corporation earning the income. Section 10 of the Act provides for the apportionment of the income of corporations doing business both within and without this State. Income of corporations not doing business in California is not used in computing any tax imposed by California.

The Appellant filed a return with the Commissioner for the year 1930, disclosing its gross income, as above noted, for that year but reported that there were payable no taxes computed on the basis of such income. The Commissioner, acting on the assumption that Appellant is a corporation taxable under the Act, proceeded to determine its tax liability on the basis of the above return, Dividends received by it which were paid out of income of Union Oil Company arising from business done within this State were deducted from Appellant's gross income in accordance with Section 8(h). But 29.64397% of these dividends, i.e., the amount thereof paid out of income of Union Oil Company arising from business done outside the state, were not deducted. The Commissioner determined that the tax due the state computed on the basis of the above return amounted to the sum of $44,552.63 and proposed to assess the Appellant for that amount of tax. The proposed assessment was duly protested by the Appellant. From the action of the Commissioner in overruling Appellant's protest, this appeal was prosecuted.

Appellant maintains that the Commissioner erred in proposing the above assessment and in overruling Appellant's protest thereto on the grounds (1) that, although it is a corporation, it is not a corporation within the meaning of the Act; (2) that it is not a financial, mercantile, manufacturing or business corporation; (3) that it has not at any time engaged in doing business in this State; and (4) that to impose upon it a tax measured in any part by dividends received from the Union Oil Company would result in double taxation and unlawfully burdening interstate commerce.

Section 5 of the Act defines the term "corporation" as follows:

> "The term 'corporation,' as herein used, shall include every financial corporation, other than a bank or banking association, and every mercantile, manufacturing and business corporation of the classes referred

, to *in* subdivision one (a) of section 5219 of the Revised Statutes of the United States."

Inasmuch as the Act contains nothing from which it may be inferred that the terms "financial", "mercantile", "manufacturing" and "business" corporations were used *in* any different sense *in* it than the same were used in Section 5219 of the Revised Statutes of the United States, it seems clear that the question as to whether or not the Appellant is a corporation within the meaning of the Act involves the same considerations as the question whether or not it is a financial, mercantile, manufacturing or business corporation within the meaning of the Act. Consequently, we will turn to a consideration of this latter problem.

As noted above, the only corporations, other than banks, which are taxable under the Act, are financial, mercantile, manufacturing and business corporations doing business in this State of the classes taxable under Section 14(d) of Article XIII prior to the adoption of Section 16 of Article XIII. There is no question but that Appellant is a corporation taxable under Section 14(d) of Article XIII. But it seems equally clear that the Appellant cannot be considered as being either a financial, mercantile, or manufacturing corporation. Consequently, unless it can be held that Appellant is a business corporation doing business in this State, then it must be held that the Appellant is not taxable under the Act. The question then is, what is meant by a "business" corporation, and by "doing business"?

Neither the Act nor any decisions of courts of this state interpreting the same afford any assistance in determining what constitutes a business corporation. The same is true of Section 5219 of the Revised Statutes of the United States. Consequently resort must be had to other sources. There are numerous cases, some of which Appellant has called to our attention, *in* support of the proposition that by "business'? is meant activity engaged in for profit or gain, and consequently, that by "business corporation'* is meant a corporation whose purpose is that of personal material gain of a pecuniary nature to its members.

Thus, in Chile Copper Company v. Edwards, 294 Fed. 581, 583, it is stated that "The term 'business' means some profitable activity undertaken on its-own account." In Flint v. Stone Tracy Company 220 U.S. 107, 171, appears the statement: "Business" is "that which occupies the time, attention, and labor of men for the purpose of livelihood or profit." In McLeod v. Lincoln Medical College of Cotner University, 69 Neb.50, is to be found the following at page 553:

> "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."

Dairy Marketing Association of Ft. Wayne, 8 Fed. (2d) 626, at p. 628, asserts that "... a corporation transacting business for gain as its chief and ultimate purpose is a business corporation." To the same effect as the above cases are the following: Greenough v. Board of Police Commissioners Of the Town of Tiverton, 30 R. I. 212; People v. Board of Trade of Chicago, 80 Ill. 134; Von Baumbach v. Sargent Land Co., 61 L. Ed. 460; Del Norte Co. v. Wilkinson, 28 Fed. (2d) 8%; and Rose v. Nunnally Investment Co. 22 Fed. (2d) 102.

Since Appellant was organized solely for the purpose of acquiring and holding the stock of the Union Oil Company it maintains that it was not organized for the purpose of engaging in activity for gain or profit, but on the contrary is a passive holding company simply serving as a conduit for the transmission of dividends from the Union Oil Company to its stockholders, and hence, on the authority of the proposition for which the above cases stand, is not to be considered as a business corporation. Many cases can be found which hold that a corporation the activities of which are limited to holding stock in another company and distributing dividends therefrom is not to be considered as "doing business". See Del Norte Company v. Wilkinson, 28 Fed. (2d) 876; Rose v. Nunnally Investment Company, 22 Fed. (2d) 102; Emery Bird Thayer Realty Co. v. U. S., 198 Fed. 242; Clallam Lumber Co. v. U. S., 34 Fed. (2d) 944; Zonne v. Minneapolis Syndicate, 55 L. Ed. 428; Van Baumbach v. Sargent Land Co., 61 L. Ed. 460; U. S. v. Nipissing Mines Co., 206 Fed. 431; Argonaut Consolidated Mining Co. v. Anderson, 42 Fed. (2d) 221; and Automatic Fire Alarm Co. of Delaware v. Bowers, 51 Fed. (2d) 118.

These cases, we believe, lend support to the above view voiced by Appellant. It is true that the question as to whether a corporation is a "business corporation" is a separate and distinct problem from the qeustion as to whether a corporation is "doing business" for clearly a corporation can be a business corporation, i.e., organized for a business purpose, without actually engaging in doing business,. and, possibly, vice versa. But if a corporation actually does all that it is organized to do, for example if a corporation organized to acquire and hold the stock of another company and to distribute the dividends therefrom, actually does all this, and yet is not to be considered as doing business, then it would seem that it could not be considered as a business corporation, unless, for some reason unknown to us, it can be held that a corporation is a business corporation although it neither does business nor has the power or right to do business.

Consequently, it would seem that, on the authority of the above cases and reasoning, it might very well be held that Appellant is not a business corporation, and hence not taxable under the Act. However, we are impressed by the consideration that Appellant was organized, and its existence maintained, for some purpose, and that that purpose is not a philanthropical, charitable, or religious one, but rather is definitely commercial in its nature. It may be that Appellant was not organized to make a gain or profit in the same way or by the same kind or type of

activity as a bank or an oil company. But that does not mean that Appellant was not organized to engage in activity which would result in a financial or pecuniary gain or profit to its stockholders, The creation and continued existence of Appellant necessarily entails some considerable expense. It maintains an office; has at least one executive officer to whom it pays a salary, and it employs bookkeepers, stenographers, and other clerical aids. This expense must, of course, be borne by the stockholders. If it were not expected that gain or profit or advantage should accrue to the stockholders, then it may very well be asked, why was Appellant created, why has it been continued in existence, and why should stockholders in Union Oil Company be willing to surrender their shares in such company for shares in the Union Oil Associates? It is to be noted that by virtue of the powers and privileges incident to being a shareholder in the Union Oil Company, and also by virtue of the power expressly given it in its articles of incorporation, Appellant was and is in a position to participate in formulating the policies and directing the activities of the Union Oil Company. It may be that by the creation and maintenance of Appellant it was expected that benefit or gain would accrue in the form of a more profitable conduct of the business of the Union Oil Compar resulting in a greater net income to such company, and hence in larger dividends to be distributed than would otherwise have been possible. We believe that Appellant was organized and its existence continued because of an expectation that a gain or reward would be reaped which would amply justify the efforts and expense involved in so doing. Consequently, we do not hesitate to hold that Appellant is to be regarded as a "business corporation" as such term is used in Section 16 of Article XIII of the Constitution and in the Act enacted to carry such Section into effect.

It is insufficient for taxability under the Act, however, that Appellant be a "business corporation". It must also be "doing business" in this State. As noted above, there are many cases holding that a corporation of the nature of Appellant engaged in activities similar to those of Appellant, is not to be regarded as "doing business". With all due respect for these cases, we are of the opinion that the issue with which we are now concerned is to be determined on the basis of an application of the definition of "doing business" contained in Section 5 of the Act. That definition is as follows:

> "The term 'doing business,' as herein used, means any transaction or 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 or doing intrastate business in this state, and shall include the right to do business through such incorporation or qualification."

It is to be noted that that part of the above definition which provides that doing business "shall include the right to do business through such incorporation or qualification" was added by an amendment enacted in 1931, effective August 14, 1931 (Statutes 1931, p. 2225). Both the Commissioner and the Appellant devote considerable attention to a consideration of this

amendment. The Commissioner states on page 3 of his reply brief that it is apparent that this amendment

> " . . . . extends the definition of 'doing business' to include the right to do business, irrespective of the fact that the corporation has not commenced business or is dormant, merely retaining its corporate franchise, It nevertheless possesses the right to do business, and shall annually pay to the State, for the privilege of exercising its corporate franchise within this State, a tax according to or measured by its net income."

In other words, the Commissioner apparently interprets this amendment to provide that corporations not previously taxable under the Act because not doing business in this State are now to be considered "doing business" in this State and hence taxable under the Act if they have the right to do business. Furthermore, it appears that his conclusion that the Appellant is taxanle under the Act was seriously influenced by his interpretation and application of this amendment.

It is to be noted, however, that if Appellant is to be regarded as doing business in this State solely by virtue of the 1931 amendment to the definition of doing business, then the assessment herein in question cannot be sustained. The income upon the basis of which the assessment was computed was received during the year 1930. The amendment to the definition of doing business did not become effective until August 14, 1931. If Appellant is to be regarded as doing business because of that amendment, then it follows that Appellant commenced to do business in this State for the first time on August 14, 1931. Section 13 of the Act provides that in the case of a corporation commencing to do business in this State for the first time, the tax for the first taxable year shall be measured by the income earned during such year. Nowhere does the Act authorize the measurement of a tax by income received by a corporation prior to the time the corporation commenced to do business in this State.

Appellant vigorously contends that the Commissioner's interpretation of the amendment cannot be accepted because it would render the amendment of questionable validity on the grounds that a corporation not actually doing business, but merely having the right to do business would be taxable under the Act whereas paragraph 2(a) of Section 16 of Article XIII of the Constitution provides that only corporations of the classes mentioned which are "doing business" shall be taxed according to or measured by their net income. Appellant recognizes that Section 16 provides that the Legislature shall define "doing business" but maintains that if the Legislature has provided that having just the right to do business should amount to doing business, then the Legislature has not defined the term "doing business" but rather has added something not germane to the term, something which sensibly cannot be considered as "doing business".

Consequently, Appellant seeks another construction of the

amendment in accordance with the well accepted rule that a statute, if possible, should be so construed as to render it constitutional. Appellant submits as a construction that by the amendment, the Legislature intended to provide that corporations should not be considered as "doing business" in this State unles: they both actually do business here, and furthermore, have the right-do business here. Under this construction, it could no: be contended that Appellant was taxable under the Act because of the amendment for the amendment would restrict the application of the Act rather than extend it.

It is to be noted that Appellant's construction is subject to criticism similar to the criticism which it makes of the Commissioner's construction. Under Appellant's construction a. corporation actually doing business in this State but not having the right to do business here would not be taxable under the Act Yet paragraph 2(a) of Section 16 of Article XIII of the constitution expressly provides that corporations of the classes there. in mentioned shall be subject to taxation according to or measured by their net income if they are "doing business" in this State and makes no exception for corporations which have not the right to do business here. If the Legislature, under the power to define the term "doing business", cannot constitutionally extend it so as to include corporations having the right to do business but not actually doing business, why should it be able, constitutionally to restrict the term so as to exclude corporations actually doing business but which have not the right to do business?

We shall not devote further attention to a consideration of the 1931 amendment to the definition of doing business inasmuch as we do not regard the amendment as being relevant to the instant appeal. The problem involved herein is whether the assessment proposed by the Commissioner is sustainable. As noted above, it cannot be sustained if the Appellant is to be regarded as doing business in this State solely by virtue of th amendment in question. Furthermore, it would seem that the amendment cannot in any way lend support to the conclusion that Appellant is doing business. Appellant has been engaged in doin practically everything that it is authorized or has the right to do. If the doing of that does not amount to doing business, the; it would seem that having the right to do that could not be having the right to do business. It would follow that unless Appellant has been actually engaged in doing business it cannot be considered as having the right to do business, and hence is not within the purview of the 1931 amendment. On the other hand, if Appellant has been engaged in doing business, it is unnecessary to consider the 1931 amendment since it would be taxable under the Act irrespective of that amendment.

Unquestionably, Appellant has engaged in activities or transactions in the course of furthering the purpose for which it wasorganized, a purpose which we have already determined to be a business purpose. Hence; it would seem that under the definition of "doing business," even as it existed prior to the 1931 amendment, Appellant must be regarded as having engaged in

doing business. That definition provides, in effect, that a corporation should be regarded as doing business if it engages in "transactions in the course of its business." This provision, we recognize, is ambiguous, but sensibly construed we think it means that a corporation should be considered as doing business if it engages in activities or transactions in furtherance of its corporate purpose, provided that purpose be a business purpose.

In support of the above conclusion are the cases which hold that the character of an Act done in furtherance of a corporate purpose is to be determined, not by the nature of the act, but by the nature of the corporate purpose it serves, i.e., if a corporation does an act in furtherance of a business purpose, it will be considered as doing business regardless of the nature of the act, whereas if the purpose in furtherance of which the act is done is a non-business purpose, it will not be considered as doing business. (See General Conference of Free Baptists v. Berkey, 156 Cal. 466, in which it was held that a corporation organized for charitable purposes did not do business when it sold certain land since the act in furtherance of its religious,,, and charitable activity, and since the act took its quality from the end or purpose it served; and see Silveira v. Associated Milk Producers, 63 Cal. App. 572.) It follows that Appellant did business in this State in 1930 and also in 1931. Consequently, under the Act, Appellant must pay a tax for the privilege of doing business during the year 1931 measured by its net income for the year 1930. Hence, it would seem that the assessment in question is valid since it was for the privilege of doing business during 1931 and was measured by net income for 1930, unless the Commissioner erred in the computation of the assessment.

The Appellant contends that the Commissioner did err in the computation of the assessment in that he failed to deduct from Appellant's gross income dividends received from income arising out of business done outside the State of California, the basis of the contention being that a failure to deduct such dividends will result in unlawful double taxation and in unlawfully burdening interstate commerce. As noted above, Appellant's gross income for the year 1930 consisted principally of $4,872.864 in dividends received by it from Union Oil Company, 29.643976% of which was paid out of income derived from business done outside the state. The Act provides for the deduction from gross income of dividends arising out of income from business done in this State (Section 8(h)) which was done by the Commissioner. But the Act nowhere provides for the deduction of dividends arising out of income from business done outside the state.

Since the Act provides (Section 7) that net income means gross income less the deductions allowed, it follows that if the Commissioner erred in computing the assessment it was not because he failed to follow the Act but rather because the Act under which he proceeded is invalid. But this Board, being essentially administrative, has consistently confined itself, in appeals coming before it, to an interpretation and applicatio of the relevant provisions of the statutes as enacted by the

Legislature and has left the constitutionality of such provisions for the courts to decide. We see no reason for deviating from this practice in the instant appeal.

Even if we should consider the constitutionality of the Act insofar as it does not permit the deduction of dividends arising from income from business done outside the state, we should be constrained, under the existing law, to hold it valid. Unquestionably, states other than California in which the Union Oil Company does business may tax the income from business done therein (Shaffer v. Carter, 252 U.S. 37). If California imposes a tax on the dividends arising out of such income, multiple taxation of that income may result. But we are unaware of any cases holding that multiple state taxation of the same income was in itself, unlawful. As we understand the law, if California has jurisdiction to tax certain income, it may tax it regardless of what other states may do with respect to the same income. Under the theory "mobilia sequunter personam" intangible property has its situs for taxation at the domicile of the owner (Farmer's Loan & Trust Co. v. Minnesota, 280 U.S. 205; Baldwin v. Missouri, 281 U.S. 586; Beidler v. South Carolina Tax Commiss 282 U.S. 1; and First National Bank of Boston v. Maine, 52 sup. ct. 174). Since Appellant was and is incorporated here, it follows that stocks on which the dividends were received have their situs here. If California can tax the stock, as it can under the authority of the above cases, it would seem that it could tax the income from such stock, since it has been held that a tax on income from property is in legal effect a tax on the property (Pollock v. Farmer's Loan & Trust Co., 158 U.S. 601).

In support of this conclusion may be cited the case of Maguire v. Trefry, 253 U.S. 12, holding that a state may tax a resident trustee on income from a trust the corpus of which is outside the state. It cannot be successfully urged that to tax dividends from such stock will amount to burdening interstate commerce, since it was held in United States Glue Co. v. Town of Oak Creek, 247 U.S. 321, that a tax on net income part of which was derived from interstate commerce did not amount to taxing or burdening interstate commerce. Consistent with this case is the case of Peck & Co. v. Lowe, 247 U.S. 165, holding that Congress could tax net income most of which was derived from exports although Congress is expressly forbidden to tax exports (Constitution of the United States, Article II, Section 9). Furthermore, it is to be noted that the Act does not purport to tax net income but rather provides for a franchise tax measured by net income, and consequently even the limitations on the State's power to tax net income do not apply.

It might be argued that although, strictly speaking, the Appellant has net income which may be used as a measure of a tax to be imposed on it, nevertheless itsincome is produced by the same business which produces the income of the Union Oil Company, and, therefore, since there is but one business, there should be but one tax. To this argument we will make the same . . answer as Justice Holmes made to a similar argument in Edwards v. Chile Copper Co., 70 L. Ed. 678,682, namely, "But i-f oen business could not be carried on without two corporations taking part in it, each must pay."

In conclusion, we hold that Appellant is a business corporation, engaged in-doing business in this State during the years 1930 and 1931, and consequently that the Commissioner-acted properly in proposing the assessment herein in question.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, that the action of the Franchise Tax Commissioner in overruling the protest of Union Oil Associates, a corporation, against a proposed assessment of anadditional tax of $44,552.63, with interest, under Chapter 13, Statutes of 1929, be and the same is hereby sustainer

Done at Sacramento, California, this 10th day of October, 1932, by the State Board of Equalization.

R. E. Collins, Chairman
Fred E. Stewart; Member
Jno. C. Corbett, Member
H. G. Cattell, Member

ATTEST: Dixwell L. Pierce, Secretary